

June 2019

Trust in water

## **Bilateral markets - Call for information**

## About this document

This document is a call for information seeking views from interested stakeholders about the development and implementation of a bilateral market in water resources in England (there are currently no plans for such a market in Wales). By a “bilateral market” we mean a third party provider of water resources (such as an out-of-area water company or other holder of an abstraction licence) contracting directly with a retailer to sell water to its business customers.

In ‘[Water 2020: Our regulatory approach to water and wastewater services in England and Wales](#)’ May 2016, we set out how we intend to change the way we regulate to enable the sector to address the future challenges it faces and enable and encourage greater efficiency within the water sector. In [Delivering Water 2020: Our final methodology for the 2019 price review](#), we introduced measures to make it possible for markets to play a more significant role in the supply of water resources.

However, measures related to the introduction of bilateral markets for water resources are contingent on certain provisions of the Water Act 2014 being commenced. Prior to commencement we need to identify and address policy issues, and consider the role of bilateral markets within the broader evolution of the development of water resources, including [the new National Framework](#) and the new cross-regulatory initiative, [Rapid](#). This call for information will inform this process.

We welcome responses from a wide range of stakeholders. We are particularly interested to hear the views of parties who would be interested in participating in a bilateral market (such as potential third party suppliers of water resources and retailers or self-suppliers in the business retail market) and to understand their level of interest in participating. We are also interested in stakeholders’ views on the range of policy issues that would need to be addressed in order for a bilateral market to be successfully established, and how such a market could complement, or conflict with, other means of providing water resources.

Following consideration of stakeholders’ responses to this call for information, we will consider our next steps with respect to this market and, working with relevant stakeholders, progress delivery activities.

## Contents

1. Responding to this call for information	3
2. About this call for information	4
3. Background	5
4. Issues and risks of bilateral markets	9
5. How bilateral markets might work in practice	14
6. Areas where we are seeking information	17
Appendix: Further reading	19

## 1. Responding to this call for information

We invite stakeholders to comment on this call for information by no later than 6 September 2019. You can email your responses to [bilateral.markets@ofwat.gov.uk](mailto:bilateral.markets@ofwat.gov.uk) or post them to:

Bilateral markets call for information  
Ofwat  
21 Bloomsbury Street  
London WC1B 3HF.

If you wish to discuss any aspect of this document, please direct your enquiry by email to [bilateral.markets@ofwat.gov.uk](mailto:bilateral.markets@ofwat.gov.uk).

We may publish responses to this document on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## 2. About this call for information

This call for information relates to the introduction of bilateral markets in water resources in England.<sup>1</sup> The Water Act 2014 includes provisions requiring appointed water companies to provide entry access, subject to certain conditions and exceptions, to holders of wholesale supply licences.<sup>2</sup> The power to commence the provisions lies with the Secretary of State. These provisions, if fully commenced, would facilitate a “bilateral market” in wholesale water between retailers and providers of water resources other than the appointed water company.

The power to commence the provisions lies with the Secretary of State, and we are working to support Defra to ensure it has good quality information on bilateral markets. We are also working closely with the Environment Agency (EA) and Drinking Water Inspectorate (DWI) on water resources, as it has strong links to both the environment and to public health. We intend to share the findings of this call for information with EA, DWI and Defra.

We recently [wrote to the CEOs of water companies](#) on the development of effective markets in which we outlined our view that the best outcomes for customers and society will be achieved by the sector working collaboratively to develop solutions. We encourage engagement in that spirit.

In this call for information we provide some background on the role bilateral markets could play within the broader context of the future development of water resources. We are interested in views from stakeholders on the range of policy issues associated with fully commencing the Water Act 2014 provisions and views on the best means of addressing such issues. We welcome views from all interested stakeholders, in particular from those that consider they might be party to a bilateral contract. This might be either as a buyer or seller of water resources or any other party that might have an interest in such trades (such as possible providers of water treatment services). To guide responses, we have set out some questions in Chapter 6 (on page 17). However, we don't require responses to follow this format.

---

<sup>1</sup> The Welsh Government has chosen neither to extend retail competition to all non-household customers, nor to implement the wholesale reforms set out in the WA14 at this time. Therefore the implementation of the WA14 reforms in relation to bilateral markets would only apply in England.

<sup>2</sup> Although a number of parties hold retail authorisations, no party yet holds a wholesale authorisation. For information on licensing see <https://www.ofwat.gov.uk/regulated-companies/ofwat-industry-overview/licences/#wssl>

## 3. Background

### 3.1 Sources of water

Water resources go beyond those that form part of the public water supply. They include water which is used to supply agriculture; private supplies for industry (such as for cooling power stations) and households; and recreational and environmental activities.

Appointed water and wastewater companies (water companies) currently rely on many sources of water: river abstractions, boreholes, impounding reservoirs and groundwater. Water companies also trade water with each other (known as “bulk supplies” or “trades”). Bulk supplies currently account for approximately 4% of the public water supply.

Rights to abstract water resources extends further than just water companies. Other significant entities with abstraction rights include, for example, the Canal & River Trust, farmers, landowners, non-governmental organisations and large industrial users such as brewers and power generators. Mostly these abstractors use water for their own purposes and do not supply surplus water they may have within the limits of their abstraction licences to meet water companies’ needs.

### 3.2 Policy background

The development of bilateral markets sits within a wide-ranging regulatory landscape for water resources, which includes: the [UK government’s 25 Year Environment plan](#); the [UK government’s water abstraction plan](#); the [Water Resources Management Plan \(WRMP\)](#) process, overseen by the EA and Natural Resources Wales (NRW); and the National Infrastructure Commission’s (NIC) [recommendation for long term investment in a national water network](#).

Ofwat, EA and DWI are increasingly working in closer collaboration to address water resource issues, such as through the establishment of the [National Framework for water resources](#) (including the development of regional groups); and the development of the Regulators’ Alliance for Progressing Infrastructure Development ([Rapid](#)), which is focused on ensuring that issues arising under the regulatory framework in respect of inter-regional water transfers and other joint infrastructure projects are addressed in a timely and co-ordinated way.

In 2009, the independent [Cave Review](#) of water markets recommended a number of upstream reforms to facilitate competition to meet the challenges of the sector. Proposed upstream reforms included allowing third party providers of water resources (including out-of-area water companies or other holders of abstraction licences) to contract directly with retailers supplying water to their business customers. We refer to this as “bilateral markets”.

Cave suggested bilateral markets would promote more efficient allocation of water and achieve better outcomes for customers and the environment in the form of cheaper and more resilient services.

Following the Cave Review, the [Water Act 2014](#) (WA14) was enacted, with one of its key aims being to introduce upstream competition by encouraging new entrants to offer alternative water resources to water companies or directly to business retailers. These reforms were envisaged to bring substantial benefits.

In its [Impact Assessment](#) (IA) of the proposed upstream reforms in 2013, Defra assessed the benefits to be in the region of £1.75bn (central estimate). The potential scale of upstream benefits identified in the IA are dependent on both water resources and waste management. Considering only water resources (rather than also waste management), the estimated benefits would be significantly lower. The benefits identified at the time by Defra were mainly driven by avoided capital and operational investment in maintenance of existing and new water resources, and treatment investment. The rationale is that new entrants would introduce cheaper treatment and water resources into the system and the resulting competition would discipline water companies to make more efficient and innovative decisions in operational expenditure and capital maintenance. One result might be that water companies outsource these services to more efficient providers.

Defra based its benefits assessment on the gap between the most efficient and least efficient companies at that time (2% for capex and 10% for opex) and evidence from other regulated sectors where competition had been introduced. Efficiency gains were assumed to apply against all areas of upstream services which were subject to competition.

However, the IA’s estimated benefits did not include dynamic benefits such as innovation, product differentiation and improvements in quality. It also did not consider the positive impact on any existing market mechanism measures. Moreover, the final figure did not include environmental benefits, although it was identified that the policy would, for example, reduce abstraction from river systems in water scarce areas if water is moved from water-rich to water-poor areas. In addition,

the presence of market forces would reveal information, enhancing our ability to make better informed regulatory decisions leading to better outcomes for customers.

### 3.3 Legislative background

The Water Act 2014 allows for a number of amendments to be made to the Water Industry Act 1991 in order to facilitate the creation of bilateral markets<sup>3</sup>. In essence the amendments (once commenced) will allow for two different approaches to enable bilateral markets (also illustrated in the graphic below):

1. In one case, it allows for a holder of a WSSL licence to acquire water from a third party (such as a power company) and ask a water company to introduce the water into its network for the purpose of supplying it to non-household customers in its area. The water company has a duty to take the necessary steps to introduce the water into its network.
2. In an alternative approach, it allows for a holder of a WSSL licence to acquire water from a secondary water company and ask a primary water company to

Primary water company (ie incumbent undertaker)	Secondary water company (eg another undertaker)	Wholesale licensee (WSSL licence)	Retail licensee (WSSL licence)
<ul style="list-style-type: none"> <li>• Has to provide entry access on request to a wholesale supply licensee or a secondary water company for water to be supplied by a <del>retailer to large (&gt;5ML) users only to business customers.</del></li> <li>• This must be in accordance with a section 66D agreement.</li> <li>• <b>Out of area supply duty imposes duty to accept water for it to be supplied by a retailer to business customers from secondary company and provide a connection if needed.</b></li> <li>• Request can be refused where costs are excessive or it impairs its ability to meet own obligations.</li> </ul>	<ul style="list-style-type: none"> <li>• Can request entry access for water to be supplied by a <del>retailer to large (&gt;5ML) users only to business customers.</del></li> <li>• <b>Out of area supply duty imposes duty to supply water on request to a retailer to supply its business customers (subject to being able to meet its own obligations).</b></li> <li>• This must be in accordance with a section 66D agreement.</li> <li>• <b>Retailer's request can be refused where costs are excessive or it impairs its ability to meet own obligations.</b></li> </ul>	<ul style="list-style-type: none"> <li>• Can request entry access for water to be supplied by a <del>retailer to large (&gt;5ML) users only to business customers.</del></li> <li>• This must be in accordance with a section 66D agreement.</li> </ul>	<ul style="list-style-type: none"> <li>• Can acquire water from a wholesaler to be supplied <del>to large (&gt;5ML) users only to business customers.</del></li> <li>• Otherwise water <del>must</del> <b>may</b> be acquired from primary water company <b>or</b> a secondary water company.</li> </ul>

Key:  
Remains  
Replaced  
New

<sup>3</sup> See sections 66B and 66C of the Water Industry Act 1991

introduce this water into its network for the purpose of supplying it to non-household customers in its area. Each water company has a duty to facilitate the introduction of the water into the primary company's network.

To implement bilateral markets in England the following steps need to be taken:

- The relevant sections of the legislation need to be commenced by the Secretary of State;
- Certain elements of existing provisions need to be retained where these relate to Wales, to ensure arrangements in Wales are not altered; and
- Consequential modifications need to be made to parts of the regulatory framework to reflect policy safeguards in relation to resilience, water quality and environmental protections.

While the commencement of the legislation is a matter for the Secretary of State, part of the legislation enables Ofwat to modify the instruments of appointment and WSSL licences to reflect consequential changes.<sup>4</sup> If appropriate, these changes could be addressed via codes or additional licence conditions (and guidance in relation to both).

---

<sup>4</sup> See section 55 of the Water Act 2014. This power can be exercised up to 2 years from commencement of the relevant provision.

## 4. Issues and risks of bilateral markets

In implementing bilateral markets it would be important to ensure the policy framework, implemented through the legislative mechanisms summarised in Chapter 3, maximises benefits and minimises risks. We have set out here at a high level some of the key policy areas where benefits and risks may lie. We welcome thoughts from stakeholders on how the legal mechanisms might best ensure benefits are captured and risks minimised. We note that some of these issues (in particular those relating the environment and public health) are common to the transfer of water resources more generally, and that it will be important to ensure coordination and consistency across the broader reforms to water resources.

### 4.1 Economic efficiency

Currently out-of-area water companies and third parties can provide water resources to the regional water undertaker. They can either submit bids to a water company to provide them with their future water needs (the bidding market) or under the new Direct Procurement for Customers (DPC) arrangements, third parties will be able to bid to design, construct, finance and/or operate water resources infrastructure. Out-of-area water companies can also engage in trades. All these options can bring efficiencies. However, in some instances water companies may still have the incentive and the ability to rely on their own solutions, particularly with regard to bidding markets. This appears to be borne out by the few third party options (in particular water trades) which appear in the water companies' draft WRMPs for 2019.

Under bilateral markets, out-of-area water companies and third parties would be able to trade directly with retailers,<sup>5</sup> which could bring further efficiencies. A bilateral market could ensure a wider range of solutions is considered or efficiently postpone large investment to meet new demand (which may only materialise over time and/or be subject to uncertainty).<sup>6</sup> It could reveal more accurate and reliable information

---

<sup>5</sup> The access regime would be a key feature with the aim that third party water resource providers can compete with water undertakers in a level playing field.

<sup>6</sup> For example, the [CMA in its Bristol Water plc Report](#) (6 October 2015) examined whether Bristol's proposal for constructing the Cheddar 2 reservoir (its biggest enhancement proposal for PR14) was justified given its purpose: "We found that there was substantial uncertainty over whether a power station would be built and, if so, whether Bristol Water would be the preferred option for water supply. We considered that delivering a series of smaller schemes to address a declining supply/demand balance as it arises was a more flexible and proportionate

about the cost of supply also for the existing demand, which could help improve our ability to set price controls for the segment of demand for water resources that is not subject to competition (i.e. existing rather than new demand), thereby extending efficiency gains to the entire demand for water resources. Finally, it could reveal previously unknown and cheaper ways of supplying the same or better service.<sup>7</sup>

## 4.2 Resilience

Bilateral markets can improve resilience by providing access to wider sources of supply and encourage greater connectivity, thereby allowing water undertakers additional options in preparation for drought events. Currently, improving resilience is pursued by regulation – e.g. through the WRMP process and drought plans and initial assessment of business plans as part of the price review.<sup>8</sup> Bilateral markets could increase the range of sources of supply and, as such, increase resilience by reducing the impact of the failure of any single source of supply. However, there could also be a concern around how bilateral markets might align with long-term resilience planning and how the planning processes should take account of bilateral market trades.

Bilateral markets could also provide an incentive for water undertakers and retailers to take into account customers' preferences. For example, retailers whose customers are particularly concerned about the risk of service interruptions (for a level of resilience for a 1-in-200 year drought occurrence, over an average of 25 years), may contract with third parties for contingency supplies. These could be out-of-area water companies (or abstraction licence holders) whose probability of experiencing a drought is lower than that of the water undertaker that supplies the customer. Competition from retailers could incentivise water undertakers to take similar actions and enter similar contracts. This would align the customers' demand for resilience with the water undertakers' incentives. As a result, relative to the status

---

approach to addressing any shortfall in supply in the shorter term, given the uncertain demand and the uncertainty modelled in Bristol Water's target headroom. We considered Bristol Water's arguments on customers' desire for resilience of supply, but found that Bristol Water had not provided sufficient evidence to demonstrate that immediate investment in Cheddar 2 was necessary to achieve the resilience objective, or that customers would be willing to pay higher bills to finance this increase in security of supply." (Paragraph 42).

<sup>7</sup> By way of comparison from the energy sector: "In the first rounds of the capacity auctions, the winners – small diesel generators and OCGs – were not what was anticipated (CCGTs were assumed to be the likely winners). The prices also turned out to be much lower than BEIS expected." See Dieter Helm, "[The Cost of Energy Review](#)", 25 October 2017, p. 193.

<sup>8</sup> Resilience is discussed in Ofwat's September 2017 document '[Resilience in the Round](#)'. Resilience is one of the key cross cutting themes of PR19 and we sought a step change in company business plans in how they intend to secure long term resilience and apply the planning principles as consulted on in the [Annex 4 of PR19 Final Methodology](#).

quo, customers could gain their preferred level of protection from the risk of service interruptions and, critically, potentially pay less for it.

### 4.3 Environmental outcomes

Bilateral markets would allow and incentivise the transfer of water resources from water-rich to water-poor areas. There are potential environmental benefits from reducing abstraction from water-stressed systems. Bilateral trades may also displace or defer the deployment of energy-intensive alternatives such as desalination systems (this would be beneficial where the energy required to transfer the water in the bilateral trade is lower than the alternative it is displacing).

There are some environmental risks that are associated with holders of abstraction licences changing the way in which they operate. These fall broadly into two categories:

- Licence holders increasing their abstractions, within their licence limits (therefore not bringing about an opportunity for EA to review the licence) to put water into a distribution network;<sup>9</sup> and
- Water resources being diverted into a distribution network, leading to a reduction in the quantity of water discharged into a river, impacting the river or other abstractors downstream.

Increased use of water could lead to a risk of over-abstraction. The EA has powers to limit abstractions if it considers these to be unsustainable.

Transfers of water (whether through bilateral markets or other forms of water trading) can bring other environmental risks. There are concerns about the spreading of invasive species in cases where water is exchanged across river basins. Where water is abstracted from one river system and then transported across, used and discharged into another river system there may also be issues around the volume and quality of water discharges. As these risks are similar to other options that involve the transfer of water across river basins, the regulation of bilateral markets will need to remain consistent with the regulation and mitigation requirements of other transfers, which is likely to be considered by Rapid.

---

<sup>9</sup> Bilateral markets provide an opportunity for abstraction licence holders to abstract more water. Equally under the status quo licence holders do not have strong incentive to use water efficiently, as abstraction licence fees are not based on the actual volume of water abstracted.

It is important that the regulatory framework can ensure that these risks can be sensibly managed. If it can, then overall, bilateral markets are expected to have a positive impact on the environment, through reducing the strain on over-exploited water resources and reducing carbon dioxide emissions by delaying capital intensive solutions.

## **4.4 Public health**

Water transfers can raise concerns around public health, in particular as the characteristics of water (and therefore the treatment it requires to meet public health standards) can vary from area to area. The regulatory framework can seek to mitigate this where:

- an out-of-area water company supplies treated or untreated water to another water company. This is because all the water companies, as undertakers, are currently subject to public health obligations and controls; and
- a licence holder other than a water company supplies raw water to be treated in a water company's treatment facilities. The water company would treat the water before it is inputted into its drinking water network and so the water company would retain the same compliance obligations as if it were inputting its own water or a bulk supply from another water company into its network. This would be very similar to a third party currently supplying untreated water under bidding markets.

In the above cases the water company would continue to have full statutory liability for the quality of water inputted to its drinking water network, and, therefore, there would be a strong imperative for the water company to contract effectively as to the quality of the water entering its network.

Some concerns may arise where a third party provider, other than an out-of-area water company, supplies treated water. Such a third party may not be appropriately covered by public health regulation and this issue would need to be resolved before treated water can be introduced into the drinking water network. One way to manage this might, for example, be through adopting a phased approach to introducing bilateral markets, whereby third parties initially supply raw water to be treated by appointed water companies, and, once a satisfactory means of addressing public health regulation has been identified, third parties would be able to treat the water themselves. This approach may provide sufficient time to consider how to frame and address these concerns.

## 4.5 Unintended and/or practical consequences

The development of bilateral markets will mean additional water resource providers inputting water into the distribution network. This (along with other developments, such as potential cross-regional bulk water transfers) will require a greater degree of co-ordination across and within company boundaries. The Cave review expressly referred to the role of a system operator (SO) being responsible for managing physical delivery of the water to the retailer.<sup>10</sup> Therefore, there is a potential link between bilateral markets and a future SO model, although we consider the introduction of an SO to be beyond the scope of bilateral markets alone and do not consider the current legislation as an appropriate vehicle for its introduction.

Nevertheless, the presence of any national infrastructure, which may fall within the scope of the National Framework and Rapid, could substantially facilitate bilateral markets by providing more opportunities for out-of-area water companies and third parties to supply retailers nationwide.

A key benefit of bilateral markets is that it should substantially reduce the ability of water undertakers to act on any incentive to discriminate against third parties under the current market mechanisms, as the third party will be able to contract directly with a retailer. It would also reduce the ability of a water undertaker to prefer its own solution to more efficient third party options.

---

<sup>10</sup> [Independent review of competition and innovation in the water markets](#), Professor Martin Cave, April 2009, paragraph 4.54.

## 5. How bilateral markets might work in practice

In preparation for the opening of bilateral markets we have adapted our regulatory framework for PR19 to accommodate bilateral market entry. This is envisaged to apply in areas served by water undertakers whose area is wholly or mainly in England.

Currently, a holder of a WSSL (holding both a water retail and wholesale authorisation) can introduce water into a water undertaker's supply system for the purpose of supplying its own large user customers. However, as noted by the Government during the passage of WA14, this has proved very ineffective and we have not yet witnessed any entry.<sup>11</sup>

Under new provisions introduced by the WA14, a range of third party water resource providers could engage in bilateral markets in different ways. These third party providers:

- would use the water undertaker's treatment facilities and/or its distribution network for onward supply to retail customers. They would need access to the water undertaker's treatment facilities if they intended to supply raw water; and
- could enter into a contract with a retailer to cover its long term needs, or alternatively only agree to cover short-term requirements at specific times to reduce the risk of supply interruptions (i.e. during droughts) when certain conditions apply.

The PR19 regulatory framework has already been adapted to ensure that, if bilateral markets are introduced during the period 2020 – 2025, we can accommodate this development. In our methodology for PR19 we described at a high level how the

---

<sup>11</sup> "Entrants wishing to operate a WSL licence in relation to upstream activities currently face several barriers, as noted in both the Cave review and Ofwat's own review of the WSL arrangements, including: 1) the combined licence problem – the fact that the combined supply licence requires licensees to provide both retail and upstream water services rather than allowing entrants to just introduce water into an appointed company's network; 2) the costs principle – the mechanism for determining the price licensees pay appointed companies for the use of their network is not effective and results in a lack of transparent prices; 3) the need to negotiate terms of access with the appointed company whose water and supply system they wish to use; and 4) the limited scope of the regime, excluding as it does sewerage services and limiting the regime to only the very largest customers." (See <http://www.parliament.uk/documents/impact-assessments/IA13-19A.pdf>, para 26).

access price mechanism will work<sup>12</sup> and that water companies' RCV investment until 2020 would remain protected. The practical effect of these measures is to confine most entry opportunities to new demand.<sup>13</sup>

Three illustrative scenarios for how bilateral markets may work in practice, based on discussions with stakeholders and interested third parties, are set out below.

## **5.1 Example 1: A power generator supplying water resources**

Power generators that hold abstraction licences have the ability to supply water resources. However, at present they cannot do so other than for self-supply or if they also hold a retail licence. Some power generators provide capacity for electricity generation only at specific times according to demand, while others may just supply available capacity. As a result their plants do not run continuously. In the downtime, they could supply water which otherwise would be used for cooling. Depending on the relative prices of water and electricity they may decide to supply one or the other at any given time. Power generators treat water for power generation purposes, i.e. to avoid deposits on their cooling systems. However, if they intended to supply treated water into the public water supply, they would need invest in separate water treatment facilities as the water quality requirements for drinking water are different. The quality of the water, if supplied as treated, would need to meet the standards of [the Water Supply \(Water Quality\) Regulations 2016](#) (as amended). To supply raw water, they would need access to the undertakers' water treatment works and to agree terms for treatment. Power generators would also need to vary their abstraction licence by adding an additional use which would be subject to the EA's approval.

---

<sup>12</sup> This included the introduction of an equalisation payment to ensure that efficient third parties could compete with the water companies. This is required because the latter set charges based on average cost, while the incremental cost of new water resources is often higher, reflecting the higher costs of not yet exploited water resource options. The equalisation payment aims to enable third party suppliers whom are more efficient than water companies to compete effectively.

<sup>13</sup> Information and trading platforms could also be introduced to facilitate the bilateral market. Much like the requirements for water companies to publish water resources market information, to stimulate the bidding market, an information and trading platform could bring retailers and water resource providers together. The EA is developing a trading platform at catchment level, for holders of abstraction licences to advertise water availability.

## **5.2 Example 2: Opportunities for self-suppliers**

Since the opening of the business retail market in England in April 2017 commercial businesses can choose to self-supply (that is provide their own retail services) instead of purchasing from their designated water retailer.

Self-supply licences have become popular in the first two years of the retail market, gathering interest from large companies such as Greene King, Marstons, Whitbread, and Coca-Cola.

Self-suppliers may have a particular interest in obtaining water resources from alternative suppliers, where these are available, in order to reduce their costs.

A number of the companies which have chosen to provide their own retail services also hold abstraction licences, which they use for their own industrial purposes (often drinks production). Such companies have the opportunity to explore the business case for entering future bilateral markets as suppliers of surplus water.

## **5.3 Example 3: Trading opportunities for water rich companies**

Currently some water companies have a surplus of water or may be able to develop new water resources cheaply. Other water companies may have limited options which include expensive sources, such as reservoirs or desalination plants. In PR19, we have stated that any investment post April 2020 would not be protected. This should act as an incentive for water-poor companies to find an efficient solution in the first place as investing in a solution which was not efficient relative to trading, may risk its new assets becoming stranded.

Bilateral markets provide more opportunity for water trading and act as a further incentive on water undertakers to consider accepting water trades. A water-rich company might offer to supply bulk water to a water-poor one, but the companies may fail to come to a mutually acceptable agreement, even where the trade was cheaper and had a much better impact on the environment than alternative resources. Bilateral markets would allow the water-rich company an alternative option to sell its water directly to business retailers that are active in the water-poor company's area.

## 6. Areas where we are seeking information

We welcome feedback from stakeholders on any areas relating to the implementation of bilateral markets. We intend to use the feedback we gather through this call for information to inform our thinking on how to address policy issues to ensure bilateral markets can work efficiently, effectively mitigating risks and maximising benefits. Our thinking will inform the Secretary of State in their decision on when and how to commence the relevant sections of the WA14 and exercise powers to make consequent changes to regulations.

We set out below some areas where we are seeking some specific information. However, we do not require responses to follow this format and respondents should feel free to provide supplementary information if they consider this to be helpful.

### 6.1 Question 1

A number of stakeholders have previously expressed interest in supplying water resources, either through the bidding market or in a future bilateral market. There are also a large number of WSSL licensees.<sup>14</sup> We are interested in stakeholders' views on:

- a) Whether, in principle, they would be interested in selling water resources via means of a bilateral market;
- b) Whether, in principle, they would be interested in purchasing water resources via means of a bilateral market; and
- c) Whether, in principle, they would be interested in playing some other role (such as providing water treatment services or providing other services) to support a bilateral market.

---

<sup>14</sup> An up to date list of licensees is maintained on the Ofwat website at <https://www.ofwat.gov.uk/regulated-companies/ofwat-industry-overview/licences/#wssl>

## 6.2 Question 2

Owners of water resources currently have an existing route to market through the bidding market, while retailers can contract for water resources with the regional water company. We are interested in stakeholders' views on:

- a) the advantages or disadvantages bilateral markets might have compared with the trading arrangements currently available to them;
- b) how bilateral markets could complement or conflict with existing mechanisms available for water trading; and
- c) whether they have any preference between the existing arrangements and bilateral markets (if so, why).

## 6.3 Question 3

The legal framework allows for a number of consequential changes to regulatory instruments (such as licences and codes) to effectively implement bilateral markets. We welcome views from stakeholders on:

- a) The key policy benefits that they consider need to be captured and the best means of doing this;
- b) The key policy risks that need to be mitigated, and the best means of doing this; and
- c) Whether there is a degree of prioritisation to the risks and benefits, and if so what needs to be captured as a priority and what might be better left for a more informed decision once some bilateral trading has become established?

## Appendix: Further reading

Links to relevant documents are set out below.

[Independent Review of Competition and Innovation in Water Markets: Final report](#) – Professor Martin Cave, April 2009.

[Upstream Competition: Impact Assessment](#) – Defra (November 2011, updated May 2013).

[Water Act 2014](#)

[Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#) – Ofwat, December 2015.

[Water trading – scope, benefits and options: final report](#) – Deloitte, December 2015

[Water 2020: our regulatory approach for water and wastewater services in England and Wales](#) – Ofwat, May 2016

[Delivering Water 2020: Consulting on our methodology for the 2019 price review](#) – Ofwat, July 2017. See in particular Chapter 6.

[Delivering Water 2020: Our final methodology for the 2019 price review](#) – Ofwat, December 2017. See in particular Chapter 6.

[Water resources annualised unit cost model: explanatory note](#) – Reckon, December 2017

[A Green Future: Our 25 Year Plan to Improve the Environment](#) – HM Government, March 2018

[Preparing for a drier future](#) – National Infrastructure Commission, April 2018

[Building resilient water supplies – a joint letter from Defra, the Environment Agency, the Drinking Water Inspectorate and Ofwat to water companies](#), August 2018

[Ofwat press release announcing Rapid](#) – Ofwat, March 2019

[Water abstraction plan](#) – Defra, April 2019

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500  
Fax: 0121 644 7533  
Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)  
Email: [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk)

June 2019

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](http://nationalarchives.gov.uk/doc/open-government-licence/version/3).

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

Any enquiries regarding this publication should be sent to us at [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk).

